

El jefe de PaineWebber apoya al ELA y a la 936

Por LISETTE NUÑEZ
De El Nuevo Día

MIGUEL Antonio Ferrer, gerente general de PaineWebber en Puerto Rico, publicó y distribuyó en el Congreso de Estados Unidos un folleto en defensa del Estado Libre Asociado y la supervivencia de la Sección 936.

La publicación del informe fue atacado por el Comité de Puertorriqueños de Acción Ciudadana como una señal de los recursos que está usando el Estado Libre Asociado para influenciar el Congreso.

"Van a intervenir todos estos intereses" económicos a favor del ELA, dijo Miriam Ramírez de Ferrer, fundadora y presidenta del comité. José Ramón Oyola, asesor económico de la Asociación, confirmó informes publicados por El Nuevo Día en el sentido que las corporaciones 936 están cabildeando activamente a favor del ELA en lo que concierne al plebiscito.

Pero el gerente de PaineWebber, la principal casa de corretaje en Puerto Rico, dijo que publicó el folleto como parte de su preocupación personal con el plebiscito. "Estoy protegiendo el patrimonio de mis hijos", dijo ayer en entrevista con El Nuevo Día en sus oficinas en el Chase Manhattan.

"Me tomó como cuatro meses prepararlo" con la ayuda de Augusto Font, relacionista público de PaineWebber en el país. No obstante, Ferrer hizo claro que su esfuerzo no tiene que ver con la casa que representa en la Isla. "No sé si se han enterado" dijo de sus superiores en Nueva York.

Negó que existiera presión de parte de la presente administración, o del Banco Gubernamental de Fomento o de sus superiores para publicar el documento.

Los ejecutivos del BGF no estuvieron ayer en la tarde disponibles para comentar sobre el folleto.

El folleto le costó a Ferrer menos de \$2,000, según explicó. No me cobraron la impresión, dijo. El mayor costo estuvo en el franqueo postal.

El documento, titulado "Puerto Rico: Status político y el asunto no resuelto de la Sección 936", cuenta con seis páginas, además de una carta de presentación de Ferrer.

EN NINGUN sitio Ferrer identifica su relación con PaineWebber, ni se menciona la casa. No obstante, la tipografía usada en la portada es similar a la que usa PaineWebber. Ferrer explicó que usó las maquinillas de PaineWebber para preparar el documento.

Ferrer hace una defensa de la Sección 936, alegando que sin la misma "la miseria prevalecería en la próxima generación". El documento estipula que bajo la estadidad los

beneficios contributivos "dejarían de existir".

"Así que si se acepta que sólo bajo el Estado Libre Asociado es que Puerto Rico puede mantener la Sección 936, el Congreso debe explicarle claramente al electorado el impacto económico de un cambio en el status a estadidad o independencia".



Ferrer: "protegiendo el patrimonio de mis hijos".

Ferrer dijo que le preocupa que se tome una decisión tan fundamental como alterar el status y no existe un estimado confiable de cuál será el costo de todas las alternativas.

Sin embargo, Ramírez de Ferrer dijo que la Sección 936 debe mantenerse aislada del proceso plebiscitario, porque después de todo es un beneficio que el Congreso "quita y pone cuando le da la gana", aún bajo el ELA.

Pero si se mantiene "puede ser un ingrediente dentro del plebiscito". Los congresistas no saben mucho de Puerto Rico y se exponen a visitas diarias o frecuentes de representantes de corporaciones 936 u otros intereses defendiendo el status del ELA.

Cada uno de los tres partidos políticos recibió una aportación equitativa del Congreso de Estados Unidos para costear la campaña plebiscitaria. Sin embargo, con la asistencia de personas como Ferrer, el ELA está multiplicando sus recursos, apuntó Ramírez de Ferrer.

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October 31, 1989

Hon. Buddy Mackay
Senate Office Building
Washington, DC 20510

Dear Senator Mackay:

The United States Senate is currently working on legislation which will allow Puerto Rico's electorate to choose from among three alternative models for a United States / Puerto Rico political relationship:

1. An enhanced Commonwealth of the United States.
2. A State of the Union.
3. An Independent Republic with a special relationship with the United States.

It is generally believed that a most important factor in the vote will be the perceived economic gains / pains of each alternative.

As achieved first under Section 931 and now under Section 936 of the United States Internal Revenue Code, Puerto Rico provides U.S. corporations a virtually "tax free," U.S. flag manufacturing site.

The "tax free" concept has proven to be Puerto Rico's most important economic development tool. Fully 58% of the island's total manufacturing employment and 35% of the bank deposits are directly attributable to U.S. owned factories located in Puerto Rico because of Section 936 tax advantages.

President George Bush, who supports the plebiscite process, favors statehood. However, it is generally understood that Puerto Rico's tax advantages would cease under statehood.

The elimination of Section 936 would not provide any significant new income to the U.S. Treasury, while devastating Puerto Rico's present economy due to the expected flight of these corporations.

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Senator J. Bennett Johnston, the Chairman of the U.S. Senate Committee with responsibility for the Puerto Rico status issue announced his commitment to developing a fair plebiscite process. We are certain the House leadership will adopt no lesser goal.

Section 936 is the mainstay of Puerto Rico's economy. If due to a change of status it were eliminated or phased out, Puerto Rico's unemployment rolls would be full indeed and no welfare programs could compensate the economic loss to the island.

Section 936 has been the main stimulus in Puerto Rico's ongoing struggle to the overcome the misery which plagued its citizens during the island's first half century under the U.S. flag. We believe that without such stimulus, misery would again engulf its next generation.

So if it is accepted that only under Commonwealth status can Puerto Rico maintain Section 936, then Congress must clearly explain the economic impact of a status change into Statehood or Independence to the Puerto Rico electorate.

At present the Island's electorate faces considerable and growing confusion on the crucial economic issues.

In part the confusion is being fueled by the proponents of each status alternative who regularly interpret Congressional developments on the plebiscite issue as particularly favorable to their cause. At the same time it would be illusory to expect neutrality on such issues from political parties at whose very core is Puerto Rico's political status.

So, it is Congress which must provide the Puerto Rico electorate with a clear picture of the short, medium and long term economic implications of each status alternative. Anything else would not be fair play.

The enclosed booklet presents the details of my views. I trust it will prove useful.

Sincerely,



Miguel A. Ferrer

**PUERTO RICO:
POLITICAL STATUS
AND THE UNRESOLVED
936 CORPORATION
QUESTION**

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PREFACE

The United States Congress is currently considering legislation which will allow the Puerto Rico electorate to choose from three alternative models for the United States / Puerto Rico political relationship:

- 1. An enhanced Commonwealth of the United States.*
- 2. A State of the Union.*
- 3. An Independent Republic with a Special Relationship with the United States.*

It is generally believed that a most important factor in the vote will be the perceived economic gains/pains of each alternative.

We understand the U.S. Congress is committed to "developing a fair process in which the views of the people (of Puerto Rico) can be expressed".

The immunity from federal taxes available to U.S. Corporations operating in Puerto Rico under Section 936 of the U.S. Internal Revenue Code constitutes the Island's most important economic development tool. Fully 58% of Puerto Rico's total manufacturing employment and 35% of its bank deposits are directly attributable to U.S.-owned factories located in Puerto Rico because of said tax advantages.

The elimination of Section 936 would not provide any significant new income to the U.S. Treasury while devastating Puerto Rico's present economy due to the expected flight of these corporations.

President George Bush, who supports the plebiscite process, favors statehood. However, it is generally understood that Puerto Rico's tax advantages would cease under statehood.

We don't want the U.S. Government to inadvertently affect Puerto Rico's ability to fairly decide its future nor to devastate its economy by not having correctly presented the economic realities of each status alternative.

The enclosed information presents my understanding of the 936 Corporation question, one of the more crucial issues in the political definition process.

I trust it will prove useful.

*Miguel A. Ferrer
San Juan, Puerto Rico
October 1989*

Puerto Rico's Current Economic Situation

Puerto Rico is still a long way from being the "rich" land its name implies. But the process to provide a decent life for all its citizens is well underway and significant social betterment is within grasp.

Puerto Rico's standard of living is significantly higher than that of its Caribbean and Latin American neighbors.²

In fact the island's per capita income is but a stepping stone beneath the Industrial Market Economies entry level.³

On the other hand Puerto Rico's standard of living is only one third that of the United States and half that of the state with the lowest per capita income.⁴

Even with the ongoing growth of its economy Puerto Rico's unemployment still stands at 15%; roughly three times the current level of under 5% unemployment in the continental U.S.

How Puerto Rico Benefits the Continental U.S. Economy

By virtue of its imports of Continental U.S. products and services, Puerto Rico contributes importantly to the U.S. economy.⁵

The \$7 billion Puerto Rico imported from the United States in 1987 made the island the 8th largest U.S. export market in the world for that year.

The Island is the number one per capita importer of U.S. goods. In 1987 Puerto Rico's consumers spent 41% of their personal income on products and services imported from the Continental U.S.⁶

A more important economic contribution is providing U.S. corporations with a propitious tax environment from which to actively and profitably compete in world markets.

Results? The accumulation of substantial wealth by these U.S. corporations and therefore by the nation.

Annually 936 corporations in Puerto Rico generate profits of approximately \$9 billion⁷; fully 20% of the annual profits generated by the universe to foreign subsidiaries of U.S. corporations.

Cost to the Continental U.S. Economy

Even though the 936 players are United States corporate citizens, the cost of maintaining their industrial base in Puerto Rico is minimal to the U.S. Government in terms of foregone taxes.

We boldly suggest that studies published by the Department of the Treasury erroneously concludes a loss to the economy of the Continental United States.⁹

All calculations which support the view that section 936 corporations represent a significant tax cost to the U.S. are based on the incorrect assumption that these manufacturing operations either:

1. would have been alternatively established in the Continental U.S. if Section 936 had not existed or,
2. would have the docility to accept becoming U.S. taxpayers if Section 936 were closed out.

I believe both assumptions are naive and dangerous to harbor.

Every subsidiary of a U.S. Corporation that has established itself in Puerto Rico under section 936 has had the option of establishing itself in the Continental U.S. It has also had the option of establishing itself outside the U.S.A., beyond Puerto Rico.

One can argue with certainty that the higher profits made possible by lower taxes are of singular importance in the corporate strategies that evolve into the geographical placement of these manufacturing plants in Puerto Rico.

For these very same reasons, and with similar certainty, we should conclude that if Puerto Rico is stripped of the tax benefits it can offer qualified U.S. companies, corporate strategy would seek the next best tax advantaged location; obviously not the continental U.S.

The fact of life is corporations are, and need to be, profit oriented.

To maximize profits is to survive in our very competitive world.

Everything else being equal, plants are established where planners consider they will be most profitable.

Benefits to Puerto Rico from Section 936 Corporations

Among developing countries around the world there is fierce competition to attract corporations able to establish job producing facilities in their national territory.

One result of this intense competition is that Puerto Rico faces ever stiffer competition from foreign industrial incentives packages offering much lower transportation, power, labor and other manufacturing cost which Puerto Rico can not provide.

To keep the jobs, to overcome its competitive disadvantages, Puerto Rico maintains ample tax benefits for those corporations which provide significant employment.

Since the start of Puerto Rico's industrialization effort after World War II, tax benefits have been an integral part of the island's development strategy.

So it can be said that a Puerto Rico plant location would not have been selected in the first place without its two equalizers:

1. the very low taxes which result from the unique blend of Puerto Rico's tax laws coupled with United States Internal Revenue Code Section 936 and,
2. the stability guaranteed by Puerto Rico's political union/common market with the U.S.A.

And yet, even with these tools, Puerto Rico's four decade struggle to provide its citizens a standard of living equal to that enjoyed in the Continental United States still has a long way to go.

Moreover it is evident that Puerto Rico's present condition is the evolutionary result of 90 years of political and economic policies. A sudden, drastic change of course would predictably cause irreversible damage to the island's economic underpinnings.

Taxes & Section 936 Corporations

Some believe industrialization via tax advantages is not the best way for Puerto Rico to provide a better future for its people.

They argue that under taxable circumstances that goal could be better advanced.

That even though fewer companies would be attracted to Puerto Rico, some would be. And that a change to a taxable scenario would not make all present companies pull up and leave. Some would stay. And those that do leave would not necessarily do so right away.

This argumen not sufficient justification to shake the historically evolved stability of Puerto Rico.

If it were true the federal tax advantaged U.S. corporations in Puerto

Rico did not pay any local taxes, then obviously taxes from a smaller group of corporations would produce more for the Commonwealth's coffers.

But the fact is that as a group these U.S. corporations constitute the largest single segment of tax payers to the Puerto Rico Treasury, \$400 million in 1987¹⁰. In addition to paying local income taxes these corporations also pay toll gate taxes to the Commonwealth Government when they remit dividends to their parent companies in the Continental U.S.

Still, the argument continues, such corporations should pay much more, and even reducing their number, the few remaining would contribute substantially more than all those operating in Puerto Rico today.

This elongation of the argument is also inadequate. In simplistic terms one can clearly conclude:

More companies may hire more employees than fewer companies.
More profitable companies may hire more employees than less profitable companies.

Since by nature of their tax exemption these companies tend to be more profitable companies it would be reasonable to then say that paying taxes would make them less profitable and thus less prone to expansion and hiring more employees.

The non disruptive, sensible, path to take is then clearly in favor of more, more-profitable companies, ergo; tax-free 936 companies.

The Cost of Section 936 Corporations

So who is paying the cost of keeping the 936 corporations? The answer is no one. No one is picking up the cost because there is simply no cost ... there are only benefits.

These benefits are more jobs for our citizens, better jobs.

The direct employment from these corporations is conservatively estimated at 90,000, representing 58% of Puerto Rico's total manufacturing employment.

In addition, the 936 corporate well being has permeated across the island's economy stimulating, for example, the service industries which took off in unparalleled growth beginning in 1976, the year that 936 status became a reality.

But it does not stop there. Studies indicate that indirect job creation attributable to 936 corporations has reached 270,000¹¹. This employment brings more tax collections into our economy both directly and indirectly through the well recognized multiplier effect.

Fully 35%¹² of Puerto Rico's deposit base in our financial institutions comes from 936 companies.

It would not be an exaggeration to point out that the most potent force driving the Puerto Rico economy is Section 936. It distinguishes Puerto Rico from much of Latin America; by virtue of having ample capital available, the Island has been able to evolve a sophisticated financial infrastructure and a modern manufacturing base.

Puerto Rico Taxes and 936

The local Treasury more than makes up for the foregone taxes because these operations give strength to our overall economy.

The trade-off of higher taxes on a smaller industrial base is just not acceptable to those who would revert to the unemployed lists.

Even so, some cry out that as a result of the island's unwillingness to further tax 936 corporations, Puerto Rico's tax structure is significantly higher than the Federal tax code.

This is absolutely incorrect.

The real reason taxes are high in Puerto Rico is because it still has a relatively small universe of taxpayers in relation to its population.

This condition is not the result of 936 corporations. On the contrary: the jobs such corporations provide bring additional tax revenues and thus help reduce the personal tax burden of the population in general.

At the same time. Puerto Rico's tax structure is different from that in the mainland.

In the Continental U.S. Federal Income Tax is just one aspect of taxation.

To evaluate the taxes paid by a taxpayer in the Continental U.S. one needs to consider city taxes, county taxes, state taxes, Federal taxes, sales taxes and on and on. Available exemptions, deductions as well as other tax benefits must be factored in, arriving at realistic comparison between tax jurisdictions.

This is not to say Puerto Rico's tax burden is not high, because it is.

But it is not altogether higher than those applicable to continental U.S. taxpayers.

Federal Taxes and Section 936

So if the 936 corporations are not costing anything to Puerto Rico, are they costing the U.S. taxpayers? Following the train of thought laid out earlier, 936 corporations do not cost the U.S. taxpayer anything.

One should keep in mind that all these 936 corporations are incorporated in the U.S. to avail themselves of the important benefits of Section 936.

Were it not available, these same corporations could easily, instantly reincorporate in Puerto Rico and be subject to Puerto Rico taxes, if any, and not be subject to the IRS.

Just as simply they could establish themselves in other tax jurisdictions and operate either here in Puerto Rico or overseas; away from U.S. taxes.

So where is the beef?

That 936 corporations can repatriate profits to their parent companies at a relatively low tax cost (generally under 7%) while subsidiaries of U.S. corporations incorporated in Puerto Rico or overseas would need to pay a higher percentage tax depending on their particular circumstances, if and when they chose to remit their overseas profits to the U.S.A.

Except that, once subsidiaries of U.S. corporations start accumulating funds outside the U.S. jurisdiction, not all funds need to be remitted to the U.S. and taxes paid. Even in the event that funds are repatriated, foreign tax credits would reduce the bite available to the I.R.S.

The global economy is upon us. Numerous manufacturing and commercial opportunities outside the U.S. boundaries can be funded with such monies. The immensity of the Euro-Dollar market proves this reality.

Thus to expect a bonanza of taxes for the U.S. by altering section 936 is merely a bureaucratic hope that will not materialize.

936: a Necessity

Anyone who impartially studies the impact of Section 936 on the economies of Puerto Rico & the United States will conclude it is a

good thing: that the Section 936 circumstance is immensely beneficial to Puerto Rico and immaterial to the U.S. Treasury. It is a stable, conveniently evolved, mutually beneficial condition for both the United States and Puerto Rico.

Then, why would anyone in Puerto Rico attack Section 936?

Electoral politics: winning the next election. Political expediency; cut down the perceived strengths of the opposition.

At present Section 936 provides Puerto Rico with its primary economic development tool; one which has proven extraordinarily effective.

So if it is accepted that only under Commonwealth status can Puerto Rico maintain Section 936, then proponents of the other status alternatives will downplay the role Section 936 plays in the island's economy. Therefore Congress must clearly explain the economic impact of Statehood and Independence to the Puerto Rico electorate.

Since 1952 Puerto Rico's electorate has lived under the Commonwealth status economy. As such, the average citizen has no meaningful measure by which to judge the economic implications of proposed alternate political status models. So the leaders of each status alternative feel free to interpret Congressional developments on the plebiscite issue as particularly favorable to their cause.

In short, Puerto Rico's voters face considerable confusion on the crucial economic issues of the plebiscite process.

Resolving this situation with fairness requires Congress to provide Puerto Rico's electorate with a clear, undistorted picture of the short, medium and long term economic implications of each status alternative.

Naturally these conclusions must encompass the thoughts, and definitions of each particular political status group from Puerto Rico which have been encouraged to provide their best information and participation in the formulation of these studies.

But even then Congress should understand it is illusory to expect neutrality from political movements whose central concepts face a life or death decision at the plebiscite.

In other words the proponents of those status alternatives which are less favored by the Congressionally funded studies will probably cry "foul" and possibly boycott the plebiscite process.

Nevertheless, to be able to provide appropriate information to the people of Puerto Rico, Congress must assume this risk. Fair play dictates it.

By being fair, Congress will necessarily recognize the fact that Puerto Rico's modern economy has been developed on the basis of the "tax free status" conferred by Section 936 and its special relationship to the United States. Anything else would be to undermine Puerto Rico's future and, with it, that of the Caribbean.

Miguel A. Ferrer is President of both PaineWebber Incorporated of Puerto Rico and of the Securities Industry Association of Puerto Rico. The views he presents in this essay are personal and therefore not necessarily those of either of the organizations he currently presides.

NOTES *

- ¹ 936 corporations are those U.S. - chartered companies organized under the laws of any state of the United States that are effectively exempt under Section 936 of the Internal Revenue Code from Federal tax on business income and qualified passive investment income from Puerto Rico and other U.S. possessions.
- ² in 1986 the Per Capita Gross National Product of the Dominican Republic was \$710, Colombia's \$1,230, Venezuela's \$2,920 and Puerto Rico's \$4,828.
- ³ in 1986 the Per Capita Gross National Product of Spain a member of the European Common Market, was \$4,860 compared to Puerto Rico's \$4,828.
- ⁴ in 1987 the Per Capital Personal Income of Puerto Rico was \$5,157 while that of Mississippi was \$10,204 and that of the United States \$15,340.
- ⁵ in 1987 United States Exports to Puerto Rico were \$7 billion, \$5.5 billion to Italy, \$4.1 billion to Brazil, \$3.5 billion to Venezuela and \$4 billion to Hong Kong.
- ⁶ in 1987 the Per Capita Imports to Puerto Rico from U.S. were \$2,124.
- ⁷ data Provided by Dr. Fernando Zalacain, Economist, San Juan, Puerto Rico.
- ⁸ *ibid* - note # 7.
- ⁹ the March, 1989 Department of the Treasury Sixth Report The Operation and Effect of the Possessions Corporation System of Taxation (Internal Revenue Code Section 936) projects a possible loss of up to \$1.6 billion due to operations of section 936 corporations in Puerto Rico.
- ¹⁰ *ibid* - note # 7.
- ¹¹ *ibid* - note # 7.
- ¹² *ibid* - note # 7.
- * data in Notes # 2, 3, 4, 5 and 6 by Estudios Técnicos of San Juan, Puerto Rico.